

FINAL TRANSCRIPT

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GMTN - Q2 2008 Gander Mountain Co. Earnings Conference Call

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CORPORATE PARTICIPANTS

Bob Burton

IR Squared - IR

Mark Baker

Gander Mountain Co. - CEO, President

Bob Vold

Gander Mountain Co. - CFO

CONFERENCE CALL PARTICIPANTS

Bob Simonson

William Blair - Analyst

Dan McCollem

- Analyst

PRESENTATION

Operator

Good morning, everyone, and welcome to the Gander Mountain Company second quarter earnings conference call. This call is being recorded. At this time, I would like to turn the call over to Bob Burton. Please go ahead.

Bob Burton - IR Squared - IR

Thank you, good morning. And thank everyone for joining us. Welcome to the Gander Mountain second quarter 2008 conference call. I'm Bob Burton of IR Squared. Joining us on our call today are Mark Baker, President and CEO of Gander Mountain; and Bob Vold, Senior Vice President and Chief Financial Officer. Rick Vazquez is fulfilling another business commitment. Mark will discuss business trends and merchandising initiatives. Bob will review our financial results.

We'll take your questions after that. We expect the call to last about an hour. As a reminder, the question and answer period is available to all interested parties although questions will be limited to investors and analysts. This conference call is being broadcast real time on the Internet at gandermountain.com. We will also offer an Internet replay of the call which will be available shortly after the call is concluded and will remain on our website for approximately 90 days. Transcript of this call will be posted under archives in the Investor Relations' section of our website.

Please remember that our discussion today may include forward-looking statements relating to our estimates and expectations that involve risks and uncertainties. Our actual results could differ materially from those projected in any forward-looking statement. Additional information concerning important factors that could cause our actual results to differ materially from these forward-looking statements are described in the risks and factors affecting current and future results section of our annual report on Form 10-K as filed with the Securities and Exchange Commission as well as in our subsequent reports filed with the SEC. These reports are available at the investor relations section of our website at gandermountain.com and at the SEC's website at SEC.gov. We caution you that forward-looking statements reflect our current views with respect to future events and speak only as of the time they are made and we undertake no obligation to update them in light of new information or future events. The reconciliation and other information required to be disclosed about non-GAAP measures including adjusted EBITDA, discussed during this call is available on the 8-K we filed today which is at the the Investor Relations page of gandermountain.com under the financial information tab. Now I'll turn the call over to Mark.

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Mark Baker - Gander Mountain Co. - CEO, President

Good morning, everyone. Gander Mountain reported its second quarter included record sales and adjusted EBITDA second quarter and year-to-date. In fact, it is the strongest second quarter operating results in our history. Margins improved. Expenses were well-managed in a very difficult economic environment. We began to realize the seasonal benefits of our recent Overton acquisition. Sales expanded 16.8% to \$253 million. Adjusted EBITDA improved from 1.6 to \$7.6 million. Operating results were nearly breakeven at a \$180,000 loss. The net loss for the quarter was \$4.9 million, versus \$9.7 million last year.

While we were pleased with these improvements, this quarter finished below our expectations in several important metrics. We began the development of our direct business in a difficult period for our Overton's operation in the boat and marina accessories area reflecting poor weather and high and volatile fuel prices. While our direct segment delivered \$39.7 million in revenue, \$2.8 million of operating income for the quarter, sales were off from the prior year by 13% and operating margin was below the prior year. The direct business model incorporates higher gross margins and higher operating expenses, both of which are evident in Gander's consolidated results for this quarter.

The tough economic environment produced retail comparable sales at a disappointing negative 11.7, resulting in a decline of 1.6 percent in Gander Mountains retail segment revenues versus a year ago. Overall, operating margins improved 224 basis points, and operating results as I indicated earlier were at their best levels ever. Half this improvement was due to the inclusion of Overtons but the other half was due to operating improvements in our retail operations. As you can see, we came very close to turning the second quarter into a profitable period for Gander Mountain.

From an operational viewpoint, merchandising trends were better than our reported comp in used firearms, firearm security, ammunition, hunting equipment, boats, salt water fishing, rod and reel combos, camping and footwear. Our new apparel offering reported soft results overall, particularly hot weather items like shorts and T-shirts. Bright spots in this category include men's fishing shirts and denim. We continue to be in better inventory and product offering position.

Early in the year we announced that we would reduce our footprint in ATV in order to improve profitability. Sales in this category declined 60% for the quarter, which represents about 2.3% of our comp decline. Also in the power sports area, we saw continued growth in the more profitable boat business.

This performance also reflects a shift in our annual marketing allocation toward the second half of the year, both in retail and to support the launch of our direct business. In the quarter just finished, advertising expanded in our retail segment declined from \$4.4 million to \$2.8 million for a 35% decrease. For the first half in our retail segment, advertising expenses dropped from \$9 million to \$5.2 million. This not only affected our overall comparable sales performance on the year-to-date, but affected early performance in new stores opened since last fall.

Over the second half of the year, as we go up against the sharply lower comparable sales from last year, we've increased our marketing allocation in support of all of our activities including stores, catalogs, direct mail and our new product offering. The launch of our eCommerce and catalog efforts are two of the most important initiatives for 2008. These important steps in building a multi channel retail operation that goes to market nationally across all channels and brings us new customers. Since our last call, we've achieved several critical milestones in development of the direct business.

Gandermtn.com was launched successfully on August 3, with a focused selection of over 11,000 SKUs. We've had the opportunity to learn from others that this site is among the best in features and navigation. Traffic to the site has been very good and customer comments have been very supportive and positive. We'll continue to grow the product assortment and site features over the rest of the year.

I'm also very excited to introduce the first Gander Mountain catalog which is being printed as we speak. The first catalog since 1996 arrives in customers' homes in early September. The 244 page catalog is filled with best in Gander Mountain stores. This

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initial mailing will give us important learnings in the catalog business while reintroducing the brand to loyal Gander Mountain customers in the direct channel.

Let me update you on the Focus 25 stores. We continue to provide additional management resources, marketing support, focus on merchandising initiatives, as well as operational execution. We continue to test and launch new ideas out of these formats. One example: for the past several months we've been testing zone coverage or quarterback, method of assisting customers. In these stores we have seen an improvement in average ticket and customer service during the test. As a result of this test, with some refinements, the zone coverage practice is being rolled out in all Gander Mountain stores.

For Gander Mountain our financial outlook for fiscal 2008 includes the following. We expect to have revenues over \$1 billion. We anticipate continued expansion of the initial margin based on inclusion of our direct segment, increase owned-brand, and improving mix of products and better inventory management. We continue to build a platform of long-term success in the direct business. We will continue to manage our cost carefully against our sales outlook. We anticipate a significant reduction in revolving credit facility debt by year end resulting from improved cash generation.

Looking forward, although the economic environment has been very challenging for all retailers, we are entering the seasonally strong second half of our fiscal year. Given our modest expectations for comparable sales, targeted advertising spend for our sales initiatives, we expect to reach our goal of profitable performance this year, although we continue to regard the economy as an important and volatile factor in this outlook. We are committed to our customers, our supplier partners, and to our dedicated associates to provide great service every day. Bob?

Bob Vold - Gander Mountain Co. - CFO

Thanks, Mark. For the quarter, Gander Mountain reported sales of \$252.9 million and revenue growth of 16.8% on a comparable store sales decline of 11.7%. The net loss for the second quarter of fiscal 2008 was \$4.9 million, as compared to a net loss of \$9.7 million last year. This improvement reflects the inclusion in our results of \$39.7 million in revenue, and \$2.8 million in operating income for our direct business, as well as a lower cost structure in the retail segment. However, as Mark said, it was short of our goal of a profitable second quarter.

Adjusted EBITDA of \$7.6 million was a record for the second quarter, compared with \$1.6 million in the second quarter a year ago. Adjusted EBITDA is a non-GAAP financial measure. A reconciliation of adjusted EBITDA to net loss is available on the Investor Relations page of our website at gandermountain.com.

Consolidated initial margin improved 239 basis points reflecting increased initial margin of 140 basis points in the retail segment as well as the inclusion of our direct segment in the mix. This extends the trend of increasing initial margin in nine of the past 10 quarters. Overall, gross margin improved 288 basis points. Other factors impacting gross margin performance included increased penetration of owned brands from 10% to 15%, plus in the inclusion of Overton, and deleveraging the retail segment due to store occupancy costs.

Turning to expenses, recall that our SG&A includes store operating expenses of our retail segment, operating expenses of the direct segment and corporate, general and administrative expenses. In the quarter, SG&A expenses increased \$11.7 million or 21%. As a percent of sales, SG&A increased 95 basis points to 26.5%, reflecting \$14.6 million of expenses related to the direct segment, offset by leverage of 97 basis points in the retail segment. Preopening expense was \$408,000 which reflects costs for two stores opened early in the quarter. With our store program for the year complete as of the end of May, we do not expect any preopening expense for the remainder of the year.

As a result, we reported an operating loss of \$180,000 versus an operating loss of \$5 million a year ago. Net interest expense was \$4.5 million for the quarter, flat versus last year. The loss per share for the second quarter of fiscal 2008 was \$0.20 per share, compared to a loss per share of \$0.48 in the comparable period. Comparisons of earnings per diluted share year-over-year are

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reflective of the Company's issuance of equity capital in December 2007 which increased the number of weighted average shares outstanding year-over-year. The weighted average diluted shares for the quarter were 24.1 million shares, compared with 20.3 million in comparable period last year.

At the close of the second quarter, Gander Mountain operated 115 stores and approximately 6.5 million square feet of retail space. Total square footage year-over-year increased 13.6%. The average square footage per store increased approximately 6.7% to 56,400 square feet for the second quarter compared to the same quarter last year. Our comp store base at the end of the quarter was 98 stores.

Inventory balances ended at \$417 million, versus \$419 million in the second quarter of last year. \$21 million of the current inventory is related to the direct business, resulting in a 5.4% decline in inventory in our retail segment. Our retail segment inventory per square foot excluding preopening inventory was \$61.04 versus \$72.60 a year ago, down 15.9% from the prior year. These results demonstrate our continued efforts to be more efficient and better optimize our inventory. On a trailing 12 month basis, retail sales per square foot were \$156.25, versus \$176.47, down 11%. Our average retail ticket increased 4.2%, to \$58.83 for the quarter. We demonstrated significant improvement in operating cash flow during the quarter and the first six months.

For the year-to-date cash used in operations improved from \$68 million last year to \$9 million this year, as a result of lower retail segment inventory levels and improved working capital management. Half that improvement came in the second quarter, where cash used in operations swung from the use of \$20.6 million a year ago quarter to a cash contribution of \$9.2 million this quarter. Cash, capital expenditures were \$12.3 million for the six month period versus \$17.5 million last year, primarily for new stores.

As we indicated in earlier calls, total capital expenditures including capital leases will be less than \$25 million in 2008. Depreciation and amortization was \$15.7 million for the six month period versus \$12.7 million a year ago. We ended the quarter with borrowings under our revolving credit facility of \$260 million, and shareholders equity of \$165 million. Current availability under the Company's senior credit facility ranges from 30 million to \$35 million and is expected to increase throughout the holiday season. Our plans for fiscal 2008 remain conservative as we have planned for no further new stores and a mid single digit negative comparable sales performance. As we enter the seasonally strong second half, we are encouraged by a stronger allocation of marketing dollars in the retail segment and the opportunity offered by our direct business. Our focus remains on cost control. In all stores we will continue to work toward improvements in business fundamentals, product gross margins, expense control, store profitability, and management of inventory to continue to develop a stronger business structure. Now we're ready for questions.

QUESTIONS AND ANSWERS

Operator

The question-and-answer session will be conducted electronically. (OPERATOR INSTRUCTIONS) We'll go first to Bob Simonson with William Blair.

Bob Simonson - William Blair - Analyst

Good morning. The catalog expense I think Mark and Bob, you mentioned that your expense -- your advertising dollars were down in the first half, they'd be up in the second half. The catalog that just hit, is that in advertising dollars or do you allocate that differently?

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Mark Baker - Gander Mountain Co. - CEO, President

Bob, that will be included in expenses as the catalog is sent out and we record revenue. So that expense -- there's some production cost potentially but relatively small to date. Most of that would be expensed as we go throughout the remainder of the year.

Bob Simonson - William Blair - Analyst

Are those expenses, however, allocated part of your advertising estimate of being up or is that in a different line item?

Bob Vold - Gander Mountain Co. - CFO

Again, I think the advertising dollars that we're talking about specifically are probably in the retail segment.

Bob Simonson - William Blair - Analyst

Okay.

Bob Vold - Gander Mountain Co. - CFO

Again, but included in total, we're going to get the benefit of the catalogs in the retail stores as well.

Bob Simonson - William Blair - Analyst

Okay. And dare go to the area that says how has business been since the end of the quarter or how did it pan out in the months of the quarter?

Mark Baker - Gander Mountain Co. - CEO, President

Bob, what we're seeing right now is improving trend, ad the year ago as we mentioned when we went through our third quarter, our business review came under a great deal of stress by the first part of September. We are seeing improvement in the first part of August. As you know, we're like three, four weeks in the quarter right now as we speak, but we expect it to moderate. We're up against pretty soft comps of a year ago.

Bob Simonson - William Blair - Analyst

You guys talk too fast. Can you reiterate what you said about the categories that are strong and weak?

Mark Baker - Gander Mountain Co. - CEO, President

The strong categories, stronger than the business in general have been firearm, firearm security, ammunition, hunting equipment, and surprisingly, in some cases, boats, but probably speaks more to our inventory as we grow into the boat business. We actually grew the boat business. Saltwater fishing gear, obviously, as we rounded out some of these markets, rod and reel combos, camping and footwear.

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Bob Simonson - *William Blair - Analyst*

Footwear is good?

Mark Baker - *Gander Mountain Co. - CEO, President*

Yes.

Bob Simonson - *William Blair - Analyst*

And the weak was?

Mark Baker - *Gander Mountain Co. - CEO, President*

Weak was apparel was much weaker than we had anticipated. As you know, we rolled out a lot of new Gander Mountain branded apparel this spring. Probably with the reduction in advertising, didn't give the exposure to some of the net new products for the consumers. That was a disappointment. We weren't very happy about that. New firearms and obviously ATVs were significantly off.

Bob Simonson - *William Blair - Analyst*

And is the increase in advertising, is that somewhat generic or is it product-oriented and is it aimed towards that apparel?

Mark Baker - *Gander Mountain Co. - CEO, President*

What I want you to think about the advertising, is the allocation. As you know, we've reduced it very significantly in the front half. Our overall spend may not be up much for the year. But the allocation of it is going to be stronger to the back so it will include electronic, radio, TV, in certain segment markets as well as print vehicles. But a fair amount of our effort has been around driving store traffic through the web as well as the support of the catalog.

Bob Simonson - *William Blair - Analyst*

There isn't going to necessarily be an increased focus on either firearms or apparel or footwear?

Mark Baker - *Gander Mountain Co. - CEO, President*

We think that the catalog is particularly good at describing apparel and footwear and there's a fair amount of dominance in that, 244 pages devoted to that. Which will obviously transact direct, as well as encourage people to look at our assortments in the store.

Bob Simonson - *William Blair - Analyst*

What was your comment, again, if you could reiterate on your gross margin expectations for the second half?

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Mark Baker - Gander Mountain Co. - CEO, President

Continued growth of gross margin. Nine out of ten quarters, expect to see that continue in the third and four quarter, gross margin expansion.

Bob Simonson - William Blair - Analyst

Okay. And I think, Bob, you said you're done with your store expansion program for this year. Any preliminary thoughts on next year?

Bob Vold - Gander Mountain Co. - CFO

No, we really haven't made any public announcements yet as relates to -- again, for the most part, our focus is on the growth in the direct side. Doesn't mean that we couldn't add a couple stores but for the most part our focus is on the direct side as well to continue to improve operations on the retail side.

Bob Simonson - William Blair - Analyst

Would you possibly do -- in seems like each year you remodel or move a store from an old site to a small store. Might there be some of them planned for next year?

Mark Baker - Gander Mountain Co. - CEO, President

I think, Bob, for next year, we don't have any of those planned. We don't have any leases that are coming up for 2009. In '10, we might have one or two. I think next year, as Bob mentioned, we probably have a couple stores of growth but we're really focused on making sure that we have this multi-channel thing in place with a lot of catalogs being delivered and strong web presence for next year, which, again, to try and drive people to our stores with more knowledge of our assortments, as well as to do direct business. We want to make sure that we're in good places to do that.

Bob Simonson - William Blair - Analyst

Bob, do you have a year-end '08 estimate for CapEx?

Bob Vold - Gander Mountain Co. - CFO

I think I said in the call, less than \$25 million. I mean, that includes capital leases as well.

Bob Simonson - William Blair - Analyst

Under 25. And so it sounds like it could be even a smaller number next year?

Bob Vold - Gander Mountain Co. - CFO

Certainly, with a limited number of new stores; correct.

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Bob Simonson - *William Blair - Analyst*

Very good. Thanks very much.

Mark Baker - *Gander Mountain Co. - CEO, President*

Thanks, Bob.

Operator

(OPERATOR INSTRUCTIONS) We'll go next to [Dan McCollem with Red Cap].

Dan McCollem - *Analyst*

Hi, good morning.

Mark Baker - *Gander Mountain Co. - CEO, President*

Good morning, Dan.

Dan McCollem - *Analyst*

Can you -- I may have missed this, but can you talk about where the cash flow generation is going to come from in the second half of the year to pay down the revolver?

Bob Vold - *Gander Mountain Co. - CFO*

Really comes from a couple areas. Obviously, the second half of the year is our strength. I mean, 65% of our business is expected in the second half of the year, from a historical standpoint. Also, again, it's really inventory management, again, as we reduce inventories from a seasonal standpoint at the end of the fiscal year. Again, most of the paydown will be relative to performance in the latter half, I mean, the holiday, the late hunting and holiday seasons, November, December, from that standpoint. So again, that's where the most significant portion of the paydown results from.

Mark Baker - *Gander Mountain Co. - CEO, President*

I think what Bob said, you know, 15% reduction in inventory that we've seen thus far through the second quarter, same store basis, percentage square footage basis, we feel good about that. Our inventory trends are getting the right inventory. We're flowing it better than we've ever done before, merchandising and such, with the reduction of in some cases, ATVs, power sports, inventories have gone down significantly. So between that and the cash from operations, we feel very good about paying down the revolver.

Dan McCollem - *Analyst*

Okay. And where is the -- what was the borrowing base as of the end of the quarter and what was the availability as of the end of the quarter?

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Bob Vold - Gander Mountain Co. - CFO

Again, we just said availability today is generally ranges from 30 million to \$35 million category, increases as we go as availability as advanced rates continue to increase during the remainder of the fall. The number at the end of the quarter would not be significantly different than the 30 to 35. It may vary a little bit, but not significantly.

Dan McCollem - Analyst

Okay. Thanks.

Operator

With no further questions in the queue I would like to turn the conference back over to Mr. Baker for any additional or closing remarks.

Mark Baker - Gander Mountain Co. - CEO, President

Thanks for tuning in today for the Gander Mountain call. I would like to thank all of our people working in these great stores to service 3.9 million customer transactions in the quarter. They are the real driver of our success. We look forward to talking to you in the third quarter.

Operator

That does conclude today's presentation. We thank you for your participation and you may now disconnect.

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